

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

MINUTES

March 15, 2000

The Capital Projects and Bond Oversight Committee met on Wednesday, March 15, 2000 at 8:30 A.M., in Room 111 of the Capitol Annex. Representative Jodie Haydon, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Jodie Haydon, Chairman; Senator Bob Leeper, Vice Chairman; Senator Bob Jackson; and Representatives Robert Damron, Paul Marcotte, and Jim Wayne.

Guests testifying before the Committee: Secretary John McCarty, Finance and Administration Cabinet; Dr. Gary Ransdell, President of Western Kentucky University; Dr. Ginny Wilson, LRC Chief Economist; John Cubine and Richard Carroll, Attorney General's Office; Dr. Gordon Davies, President of the Council on Postsecondary Education; and Ed Hatchett, Auditor of Public Accounts.

LRC Staff: Mary Lynn Collins, Pat Ingram, Jack Affeldt, Lola Williamson Lyle, Kevin Mason, Eric Evans, and Shawn Bowen.

Representative Marcotte made a motion to approve the minutes of the February 16, 2000 meeting as submitted. The motion was seconded by Senator Jackson and passed by voice vote.

Chairman Haydon then introduced a new LRC staff person, Mr. Kevin Mason, formerly with the Department of Education. Mr. Mason has been assigned to the LRC Economists Office and will also work with the Capital Projects Committee.

Chairman Haydon said the first item of new business related to a proposal by Western Kentucky University (WKU) to transfer its housing assets to an unaffiliated non-profit corporation, the WKU Student Life Foundation. He said the assets will continue to be used for the benefit of the University and its students. The proposal also includes a \$35 million capital improvements project related to those assets.

Chairman Haydon introduced Finance and Administration Cabinet Secretary John McCarty; Dr. Gary Ransdell, President of WKU; and Dr. Gordon Davies, President of the Council on Postsecondary Education (CPE), to discuss the proposed transfer of assets.

Secretary McCarty said the Cabinet, through the Office of Financial Management, has reviewed the transaction, and believes it to be a very viable transaction, one that accomplishes WKU goals to provide safe, adequate, and competitive-priced housing for its students.

Secretary McCarty said the Cabinet's staff has reviewed the pro formas that back up the debt service and believe them to be solid and proven. He said there are some other issues to work through as part of the management agreement between the University and the Foundation if the state is to have some continuing control over the operation of the assets in the future.

President Ransdell thanked Chairman Haydon and the Committee's staff for their help over the past few weeks. He also thanked Secretary McCarty for his advice, counsel, and support. He then introduced others involved in the project: Mr. David Cole, Chairman of the Board of Directors for the Student Life Foundation; Mr. Kevin Hable, Bond Counsel, Wyatt, Tarrant, and Combs; Mr. Brian Kuster, Director of Housing and Residence Life, WKU; Mr. Pat Hall, Project Manager for this project; and Mr. Steve Catron, Legal Counsel for the WKU Student Life Foundation.

President Ransdell said he considered this proposal to be the single most important project he has undertaken at WKU. He explained that while the project is not an academic initiative, it is a huge quality of life and safety initiative. He stressed that it is not a privatization issue, but rather, a recapitalization of a physical asset to benefit WKU students.

President Ransdell said the University will use these income-producing assets to generate new resources to improve those assets; the proposal does not require any financial assistance from the state, and it is a relatively common practice in other states.

President Ransdell said the University Student Life Foundation was established last year to facilitate this recapitalization and renovation of student residence hall facilities. The transaction includes 17 residence halls, ranging in age from eight to 71 years; the two newer dorms will not be involved in the renovation project. The dorms to be renovated are between 40-60 years old and have had no major renovations. Six do not have air-conditioning and half of them do not have sprinklers.

President Ransdell said the dormitories will be sold to the Student Life Foundation for their appraised value which is estimated to be \$19-\$20 million, approximately the outstanding debt on the assets. The appraisal should be completed by April 1.

President Ransdell said the Foundation expects to pay the purchase price of the dormitories through the sale of tax-exempt bonds; from these proceeds, the University will retire all outstanding debt associated with the dormitories. He said this means the state will take \$19.5 million off its books that will inure to the benefit of other state agencies, pay all transaction and renovation costs, and establish an operating and repair reserve for the Foundation. First Union Securities will be the lead underwriter for the Student Life Foundation bond issue, and the secondary underwriter will be PNC Bank and National City Bank.

President Ransdell said the Foundation will contract with the University for the management of the residence halls, and the Foundation's revenue, the sole source of security for the Foundation bonds, will consist of student resident hall fees. He said residence hall fees for a two-person room without a bath will increase by approximately 5% annually for the next 30 years. The University's total bed occupancy will be reduced from 5,300 to 4,600 beds in order to provide for more suites with private baths.

President Ransdell said the state's prevailing wage law will be followed for all Student Life Foundation construction work. The estimated construction budget is approximately \$30 million with an additional \$5 million in furnishings. He stressed that the Foundation bonds will not be considered a direct liability of the Commonwealth, and will not affect the debt capacity or credit ratings of the Commonwealth.

President Ransdell said this project includes completely renovating some buildings and providing mid-level renovations to other buildings. Work will begin this summer, and all construction will be complete by 2005. Upon completion of the work, all buildings will have fire sprinkler systems installed two years earlier than previously anticipated.

President Ransdell closed by saying the University wants to create a model that can be followed for similar transactions in the future.

Chairman Haydon asked the members if they had any questions and noted that Mr. John Cubine from the Attorney General's Office and Dr. Ginny Wilson, LRC Chief Economist, had been asked to review the proposal and would be available for questions.

Representative Marcotte said he had reviewed the materials relating to the proposal and was in favor of the project. In response to a question by Representative Marcotte, President Ransdell said this model could not apply to an academic or an

administrative building; it can only be applied to an auxiliary building with associated fees that would provide a revenue stream for debt service.

Secretary McCarty added that this project is a new and innovative way to finance certain auxiliary buildings on the University's campus. He said they hope to structure this transaction properly to minimize any concerns. In the future, there may very well be an opportunity to apply these financing techniques and the structure to other transactions, but each transaction should be reviewed individually.

Representative Wayne asked Dr. Wilson to comment on the proposed project. Dr. Wilson said she was asked by the Committee to review the proposal and comment on its debt issuing implications. She referred to a memorandum which she had earlier transmitted to the Committee.

Dr. Wilson noted that the University has brought the transaction forward as an "off balance sheet" proposal, a way to erase housing system debt now held by the University. However, she said after reviewing rating agency documents, it is her opinion that this is a financially transparent transaction, and while it may be "off-balance sheet" from an accounting sense, the rating agencies have concluded that it is not "off-credit". They have indicated that they will assess the debt of the Student Life Foundation against the debt capacity of the University, and they consider making good on this debt to be the financial responsibility of the University. Dr. Wilson said that prior housing bonds represented a direct financial commitment of the University and an indirect financial commitment of the Commonwealth, and that has not changed with the creation of the Student Life Foundation.

Dr. Wilson said if it is concluded that there is no financial difference to the University or to the Commonwealth in this transaction versus prior University housing transactions, then the real difference is the reporting and procurement requirements that the Commonwealth has imposed through the statutes on the issuance of university housing bonds, which the Foundation will not be required to follow. The University, through the Foundation, will be able to issue bonds for housing projects even though they have not been endorsed through the normal budgetary process. The bonds subsequently issued will not be under the cap for agency supported bonds recommended by the Governor and requested by the CPE. Under this legal arrangement, the debt issuance will not come before this Committee under a regular reporting requirement as would other housing bonds of universities.

Dr. Wilson said from a financial sense, this project has exactly the same implications as any other housing bonds issued by WKU, so it is a policy decision as to whether or not the General Assembly believes that housing bonds issued under the proposed structure should come under existing reporting and procurement requirements.

Representative Wayne thanked Dr. Wilson for her report. He asked Mr. John Cubine and Mr. Richard Carroll from the Attorney General's Office to comment on the legal aspects of the project.

Mr. Cubine said, at the Committee's request, his office reviewed the transaction and House Bill 1011, which relates to transactions similar to the one proposed by WKU. He said his staff had attempted to identify issues that need to be considered before such transactions move forward. Mr. Cubine referred to correspondence Mr. Carroll had prepared and asked him to further explain it.

Mr. Carroll said that according to documents he had reviewed, the central focus of the WKU transaction is KRS 164.575(7). He said the statute provides three circumstances under which the Board of Regents could dispose of property dormitories: (1) if the property is no longer needed; (2) if the property has become unsuitable for public use; or (3) if the property would be more suitable, consistent with the public interest for some other use. He said WKU has indicated they are justifying the transaction under the third circumstance. He said WKU has a basis and a reason for this, and his office was not questioning that.

Mr. Carroll noted that his correspondence identifies a number of issues, including sovereign immunity, that the Committee should consider relating to this transaction and future transactions, as well as in any review the Committee might make of House Bill 1011.

Representative Wayne asked Mr. Carroll if he was saying that WKU is justifying this transaction by saying that the dormitories would be more suitable, consistent with the public interest, for some other use.

Mr. Carroll responded that is what the documentation appears to indicate and that is what Mr. Catron, legal counsel for the WKU Student Life Foundation, had confirmed.

Representative Wayne asked for what use, other than dormitories, would the housing assets serve. President Ransdell responded that the other use would be the management by the Student Life Foundation for the use of the students, to improve their quality of life.

Representative Wayne asked if the housing would be continued to be used as dormitories. President Ransdell responded that they will always be used as housing for students. In response to further questions by Representative Wayne, President Ransdell said the new use would be to take a deteriorated, dilapidated facility and turn it into a livable facility.

Representative Wayne then noted that the State Auditor, Mr. Ed Hatchett, was present and asked if he would address the Committee concerning the proposed transaction. Mr. Hatchett praised President Ransdell as an innovator and said he applauded an attempt on the part of higher education to improve service delivery. However, he said, regardless of whether this is a recapitalization of an asset or privatization of a public asset, there should be accountability, including auditing requirements. He expressed concern that his office was not consulted regarding the transaction. He said that if this transaction is to become a model, then the State Auditor needs to be involved. He said the State Auditor should have explicit authority to examine and follow public funds received by private enterprises. He said this is standard operating procedure in other states that are beginning to address the issue of privatization, but Kentucky does not have procedures in place. He said the infrastructure should be in place before projects move forward. He closed by saying that he thought the proposed transfer is an outstanding innovation, but cautioned the members to remember that taxpayer protection is eroded if his office is not at the table when these things happen.

President Ransdell assured the State Auditor that his office would be part of the management agreement between the Student Life Foundation and the University.

Mr. Hatchett referred to House Bill 1011 which would require entities like the WKU Student Life Foundation which receives receiving assets from a postsecondary education institution, to submit to an annual audit. The proposed legislation stipulates that the Secretary of the Finance and Administration Cabinet is to prescribe the minimum scope of such audits. Mr. Hatchett said that responsibility should rest with the State Auditor, and Secretary McCarty agreed.

Representative Wayne said that while he recognized the proposed transaction represents a great deal of innovation, and it is an attempt to do something positive for the students, he had serious concerns about taking action on a major transfer of state assets without an appraisal and without a more formal structure in place. He said he had serious questions about the legality of the transfer, based on this statute cited by Mr. Carroll. In addition, he said he had serious concerns that the Student Life Foundation would not be required to follow the state procurement code and there would be no oversight by the General Assembly. In addition, even though assurances have been made relating to following the prevailing wage law and concerning oversight by the State Auditor, these assurances are verbal. Representative Wayne said in light of the questions raised, he thought the proposal was not mature enough at this point for Committee action.

Secretary McCarty assured the Committee that he and his staff have looked at this transaction in great detail, and as the management agreement is crafted, it will contain assurances relating to all applicable statutes, regulations, and policies of this

administration. He said he considered the proposed transaction a pilot project rather than a model. However, he said he was comfortable that they could deal with the concerns expressed here today. He said he wanted to assure the Committee that it is the Finance Cabinet's intent to develop guidelines and design a procedure for future transactions. He said the procedure will include bringing the proposed transactions to the Committee for review.

Representative Wayne expressed concern that the management agreement is not yet in writing and the appraisals on the property have not been completed. He also noted the decision to follow the prevailing wage law was only recently made.

Secretary McCarty said that from his perspective, prevailing wage has always been part of this transaction. Representative Wayne indicated that when he talked with President Ransdell the week before, the proposal did not include adherence to the prevailing wage law. President Ransdell responded that when that issue surfaced as something the General Assembly had an interest in, WKU was happy to include payment of prevailing wage in the proposal.

Representative Wayne reiterated his concern, citing Dr. Wilson's earlier comments, that the proposal will circumvent existing oversight and reporting requirements. President Ransdell said that the intention is to improve the quality of life for students, not to circumvent any rules.

Dr. Davies asked if he could briefly address the Committee on this issue. He said he agreed with Representative Wayne that oversight for this kind of transaction is critical. He said he would oppose the proposed transaction if he believed it was a way to circumvent the capital review processes, including that of the CPE. However, he noted House Bill 1011, which two Committee members are co-sponsors, would ensure such transactions comply with the capital review processes. He also said he agreed with the State Auditor that entities like the WKU Student Life Foundation should be audited.

Dr. Davies said what was critical relating to the proposed transfer is the need for flexibility and agility by universities as they plan for the future. He said if the transaction comes under the state's debt capacity, then there is not much sense in doing it. If it does not, this would allow WKU to move quickly to do something that would otherwise take a decade to do. He said the critical issue is whether rating agencies like Standard & Poor's, as they view Kentucky's debt capacity, consider the WKU transaction and subsequent debt financing by the Foundation as off-line financing. If they do, he said he would strongly recommend approval of the transaction, contingent upon the passage of HB 1011.

Representative Wayne asked if there were any statements from the rating agencies on the issue and cited Dr. Wilson's earlier comments.

Dr. Davies said it was his experience that the rating agencies do not issue preliminary opinions. He said he believed, at this point, the state should rely upon the opinion of bond counsel and the Cabinet.

Dr. Wilson said the rating agencies have never really considered the housing bonds to be part of the Commonwealth's debt capacity, they are rated separately from the Commonwealth. This administration, not the rating agencies, has defined the state's debt capacity as including both the revenues and debt of the universities. However, the rating agencies, both Moody's and Standard & Poor's, have made it very clear that they would count the debt of the Student Life Foundation as part of WKU's debt capacity. She stressed that the transaction, in terms of its debt implications, is no different than any existing housing bond.

President Ransdell quoted from a letter from First Union Securities to David Cole, Chairman of the Student Life Foundation: "Moody's has assured that dormitory debt is currently not considered as a rating factor in assessing either the rating or the debt capacity of the Commonwealth of Kentucky due to its self-supporting nature. Therefore, the contemplated bond issue for the Student Life Foundation will have no effect on the state's rating or debt capacity." He also noted that the Kentucky analyst for Standard & Poor's, Ellen Hennessey, is also of the opinion that the Student Life Foundation's bond financing will have no effect on the rating of debt capacity of the Commonwealth of Kentucky because they are self-supporting revenue bonds. Standard & Poor's does not consider the existing housing and dining bonds as direct liabilities on the Commonwealth of Kentucky.

Dr. Wilson said she agreed that the rating agencies treat the universities as separate entities and they have made it clear that they do not consider this to be a direct impingement on the Commonwealth's debt position. However, she noted there is an indirect budgetary issue and she said the question is: what would the Commonwealth do if this arrangement were to run into financial difficulty. She said the University would likely attempt to address those problems and would be directly affected. The real issue in terms of indirect effect on the Commonwealth is whether the University would turn to the General Assembly or to the administration for funds to address the problem.

In response to further questioning from Representative Wayne, Dr. Wilson said she saw no significant advantage to setting up the Foundation in terms of the University's debt.

Senator Jackson praised President Ransdell and Secretary McCarty for the work they had done in creating this model. He noted the current competitiveness in higher education and said he believed the proposed improvements will help recruit students. He then made a motion to approve the transfer and the proposed related capital improvements, contingent on either passage of HB 1011 or use of HB 1011 provisions in the transfer documents.

Representative Wayne asked if Senator Jackson meant the House Committee Substitute for HB 1011. Senator Jackson responded that he meant the Committee Substitute, and whether this bill passes or not, he thought the Committee Substitute was a good framework for the transaction.

Secretary McCarty said that while he was familiar with House Bill 1011, he was not familiar with the provisions of the Committee Substitute. However, he noted that it was his agency's intention to follow the spirit of HB 1011.

Representative Damron said he thought it was very bad policy to tie Committee action to proposed legislation that has not passed either Chamber. He asked Senator Jackson to consider amending his motion to approve the transfer, subject to Secretary McCarty's review and subject to WKU meeting all applicable state statutes and regulations.

Senator Jackson agreed to amend his motion and it was then seconded by Representative Damron.

Representative Wayne said he liked the original motion much better because the concepts of House Committee Substitute to HB 1011 are ones that have been refined in consultation with many parties and they are good concepts. He said he thought the current motion was too open-ended and he was opposed to the motion as amended.

Senator Leeper asked if the transfer required any Committee action. President Ransdell said they would prefer to have the Committee's oversight and approval.

Senator Leeper said he was very uncomfortable being asked to vote on the issue since a precedent is being established with this transfer and documents have not been finalized. He referenced earlier comments by the Attorney General's Office. He asked, given the fact that some members are uncomfortable without seeing the finalized documents, if action could be delayed until the agreement has been developed further.

President Ransdell responded by saying that the last time WKU came before this Committee on an issue related to residence halls, WKU was admonished for taking too long to install sprinklers in its dormitories. He explained that WKU is now coming back

to the Committee with a way to accomplish that work much more expeditiously. The dormitory improvements work is to begin this summer as soon as the bonds are issued.

In response to further questions from Senator Leeper concerning a special meeting on the issue within the week, President Ransdell agreed that delay of action for ten days or less would not be a problem.

Senator Leeper recommended that the Chair call a special meeting on the issue to review the appraisal and the finalized transfer documents. He said he was concerned about setting a precedent, noting that other universities are watching, and he wanted to be sure the conditions of the transfer are ones the members can live with.

Representative Damron said the process for the transfer has been underway for over a year. The delay in the last three months has probably caused an interest rate fluctuation of at least 1% and about \$8 million in interest costs. He said WKU has brought forward an innovative idea which provides students with better quality and safer residence halls, an idea that the General Assembly does not have to fund. He said he did not think there should be delay of another day.

Senator Jackson said he thought it was extremely important that the transfer operate in the complete and full spirit of HB 1011. After further discussion of his motion, he amended it as follows: "that we approve the transfer of assets and the proposed capital improvements, that the contract will be established by the Secretary of the Finance Cabinet with WKU adhering to all the statutes and regulations applicable to them under this new model, including prevailing wage, and finally, that we communicate this model and send this package to other universities to let them review it to see if it will benefit their institutions as well." Representative Damron seconded the motion.

Representative Wayne expressed concern relating to the reference to applicable statutes and regulations since under the arrangement WKU has developed, they are exempting themselves from all statutes, including the procurement code. He said he believed the provisions of House Committee Substitute to HB 1011 are clear guidelines and without the reference to the bill, the motion is too generalized.

Senator Leeper asked Secretary McCarty if he would be opposed if the motion required Committee review once the Finance Cabinet and WKU finalize the agreement. Secretary McCarty said that as the guidelines are developed, he would bring them back to the Committee for input.

Senator Leeper said he wanted to support WKU in its endeavor, but he said members were being asked to do something they should not be asked to do. He said even though Secretary McCarty has cautioned against calling the transfer agreement a model,

many university presidents are watching and if the transfer is approved today, it will be considered a model.

President Ransdell assured Senator Leeper that they intend to work with the Finance Secretary to ensure that it will be a model he would be pleased with.

Senator Leeper said he was being asked to give his blessing to something he was not comfortable calling a model at this time, and since the motion does not include a second review, he could not give his blessing.

Chairman Haydon called for the vote, and the motion passed by voice vote.

Chairman Haydon said there were eight items on the Committee's agenda requiring action, and because of limited time, those items would be voted on as a group. The projects requiring action included:

1) An allocation of \$25,000 from the Capital Construction and Equipment Purchase Contingency Account to the Kentucky Horse Park for completion of design for a sewer line extension project;

2) A \$100,000 locally funded project cost overrun for the Hindman Community Center/City Hall project. The new project scope will be \$600,000;

3) A lease renewal over \$100,000 annually for the Department of Housing, Buildings, and Construction (PR-3027, Franklin County);

4) A \$2,754,750 agency funded scope increase for the University of Kentucky Agricultural Plant Science Facility. The new project scope is \$21,119,750;

5) A KIA Fund E loan in the amount of \$83,920 to the City of Flemingsburg for the purchase of a solid waste collection vehicle;

6) Two new state bond issues: Kentucky Housing Corporation Single-Family Mortgage Revenue Bonds, Draw Down Series 2000 (up to \$150,000,000) and Eastern Kentucky University Housing System Revenue Bonds, Series M (\$3,100,000); and

7) Four new School Facilities Construction Commission (SFCC) school bond issues for Butler, Caldwell, Logan, and Warren Counties.

Representative Wayne made a motion to approve the action items presented by Chairman Haydon. The motion was seconded by Senator Jackson and passed by voice

vote. Representative Damron abstained from the vote citing a potential conflict of interest regarding the SFCC bond issues.

The remaining agenda items did not require action by the Committee and were passed over. These items included:

1) A project report from the Finance and Administration Cabinet reporting an allocation of \$160,000 from the Emergency Repair, Maintenance and Replacement Account for the Morehead State University Camden-Carroll Library Roof Replacement project;

2) Two project reports from the Department for Facilities Management reporting a lease modification for the Natural Resources and Environmental Protection Cabinet (PR-3322, Franklin County) and an emergency temporary lease for the Department of Military Affairs (PR-4485, Franklin County);

3) Three follow-up reports from the Office of Financial Management for previously issued bonds: Kentucky State Property and Buildings Commission Revenue Bonds, Project No. 65; Kentucky Infrastructure Authority Wastewater Revolving Fund Program Revenue Bonds, 2000 Series F; and Kentucky Infrastructure Authority Drinking Water Revolving Fund Program Revenue Bonds, 2000 Series A; and

4) Six 100% locally funded bond issues for Davies, Elliott, Lincoln (2), Logan, and Mercer Counties.

Chairman Haydon said the Committee will hold its next meeting during the veto session, either April 11 or April 12.

With there being no further business, the meeting was adjourned at 10:00 a.m.